22.04 Examples #3 at Year End

Consolidations After the Date of Acquisition

Class Example #3—Acquire 100%, consolidate at year end

The following example assumes the acquirer used the equity method to account for the majority investment during the year.

Let's look at a consolidation performed after the date of acquisition. Again, assume that P acquired all (100%) of S on 12/31/X1 for $900 cash, that equipment with a 5-year life had a fair value exceeding book value by $100 on 12/31/X1, and that goodwill, which came to $200 on 12/31/X1, is believed to be impaired as of 12/31/X2 and, as a result, only worth $195. Income during the year for P was $3,000 and S was $150. The investment is accounted for under the Equity method. Let's look at the consolidating worksheet that might appear one year later, on 12/31/X2:

Summary: Acquire 100% for $900 on 12/31/X1, and consolidate on 12/31/X2

- Income during the year:
  - P – $3,000
  - S – $150
- Equipment useful life = 5 years
- Goodwill Impaired by $5
- Investment accounted for under the **equity method.**

To account for S's income under the equity method:

Investment	150	
Equity in earnings (I/S)		150

To Depreciate the Equipment (100/5 = $20)

Equity in earnings (I/S)	20	
Investment		20

To record Impairment of Goodwill:

Equity in earnings	5	
Investment		5

Investment	
900	
150	20
	5
1,025	

To consolidate at year end:

C/S	100	
APIC	100	
R/E	550	
Equipment (100 – 20)	80	
Goodwill (200 – 5)	195	
Investment		1,025

Accounts	P Co	S Co	Debits	Credits	Consol
Cash	3,100	250			3,350
Equipment	8,000	500	80		8,580
Inv in S	1,025			1,025	--
Goodwill			195		195
$1 CS	(1,000)	(100)	100		(1,000)
APIC	(3,000)	(100)	100		(3,000)
RE	(8,125)	(550)	550		(8,125)

In the earlier example, the retained earnings of P and S were $5,000 and $400, respectively. The retained earnings of both companies have changed, of course: P earned $3,000 from its separate operations, and S earned $150. P's bookkeeper has used the equity method of accounting, and has reported $125 equity in earnings of S. This is because the $150 income is reduced by depreciation on the $100 equipment excess over 5 years, for $20, and impairment of goodwill resulted in a $5 reduction in its carrying value from $200 to $195.

Similarly, the net adjustments to the equipment and goodwill accounts are reduced by accumulated depreciation and impairment adjustments, respectively. In the above example, no separate accounts were presented for accumulated depreciation and impairment adjustments, so adjustments were made to the asset accounts directly.